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OFFICE OF REPORTS AND ESTIMATES, CIA
 FAR EAST/PACIFIC BRANCH

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INTELLIGENCE HIGHLIGHTS NO. 33
 24 DECEMBER 1948 - 4 JANUARY 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

Japan's trade with China proper expected to remain at low level, whereas its trade with Chinese doing business in Southeast Asia is promising (page 2).

Coming Japanese elections will probably reflect a growing political strength of the Japanese Communist Party (page 2).

The announced completion of Soviet troop withdrawal from North Korea will not diminish substantially Soviet influence in or control over that area (page 3).

Police measures are now considered necessary to spur lagging rice collections in the Republic of Korea (page 3).

Inactivity characterized China's battlefronts during the past week (page 4), while attention shifted to Fu Tso-yi's personal peace offensive (page 4). Meanwhile, Chiang Kai-shek announced in his New Year's address that he is willing to negotiate peace at 'his' price (page 5), and called a meeting of top provincial and military leaders in a bid for a vote of confidence (page 5). In Sink ng Province, Chiang Kai-shek has appointed a pro-Soviet governor (page 6). Prior to Chiang's New Year's speech, the Chinese Communists broadcast that they will not permit Kuomintang participation as a Party in the Communist-controlled government to be established for all of China in 1949 (page 7).

The Dutch are adopting conciliatory tactics in Indonesia (page 9).

In Indochina breakdown of the French-sponsored Xuan Government appears possible (page 9).

In Burma the political and economic situation is likely to deteriorate further in 1949 (page 10).

The Philippine Government has begun 1949 by instituting import control and a managed monetary system (page 10).

In succeeding sections of this Weekly the following marginal notation is used:

- (1) "A", "B", or "C" --important in B/FE's opinion of the item, with "A" representing the most important ones.

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KOREA

The USSR has announced completion of evacuation of Soviet troops from North Korea. Withdrawal was overland through northeastern Korea into the USSR Maritime Province where, it is believed, these troops will form a reserve which could be re-deployed into North Korea with great rapidity. Soviet withdrawal leaves behind a strong Communist organization, however, it is probable that a limited number of Soviet personnel, both military and civilian, have remained in North Korea in order to assure the continuance of the ties between the government of North Korea and the USSR.

"B"

Rice collection lags. On 29 December Korean officials reported that the Government rice collection program had achieved only 32.2 percent of the final goal. The Agriculture Minister now admits that the "voluntary" program has been a failure and the government has decided to exert force to speed collections. However, previous experience in Korea has demonstrated that if the bulk of the rice is not collected by 1 January, it will have disappeared in illicit channels. It now appears certain that the government will fail to collect more than 50 percent of the quota, which will result in widespread economic unrest and further inflation.

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CHINA

The focus of China's civil war spotlight shifted this week from the strangely inactive battle zones of North and Central China to the individual maneuvers of Nanking, Peiping, and Tientsin politicians and their peace offensives. Meanwhile, Peiping and Tientsin continue to be surrounded by superior Communist forces but as yet no siege operations against either city have been evidenced. In Central China the Nationalists have withdrawn nearly all of their remaining forces south of the Yangtze leaving only a small inadequate holding force between Pangfou and Fukou. Effective Nationalist organized resistance has virtually been eliminated and the Communists are capable of administering the coup-de-grace at any time. Both forces, Nationalist and Communist alike, appear at present however to be awaiting the outcome of current peace feelers---hence the lull in military operations during the past few days.

"A"

FU Tso-yi is believed to be seeking a "separate" peace. A local peace between FU Tso-yi and the North China Communists appears to be in the making. This "peace" would entail the peaceful turnover of the great North China cities of Peiping and Tientsin with these cities declared "open." FU, whose military and economic position is considered hopeless, is believed to be actively attempting to bargain with the North China Communists and at least two meetings have reportedly taken place without an agreement being reached. However, some sources believe that FU will be forced to accept a settlement on the Communists' terms in the immediate future. FU's bargaining points--his possession of Peiping and Tientsin and the clearly expressed desire of the local populace for peace--are quite slim, but his present propensity to seek an "honorable peace" locally can be adduced from his refusal thus far to attend the Generalissimo's military conference in Nanking, as well as his attempts to prepare public opinion in the two cities for the inevitability of compromise. In fact FU has already felt impelled to surrender, without a fight, the city of Kalgan, turning over intact to the Communists the city's industrial installations on the grounds that they constitute "national wealth" belonging to the people of China. Apart from this, FU has reportedly drafted a statement, to be handed to the Communists, to the effect that he is reluctant to submit the cities of Peiping and Tientsin to the fortunes of war and, to help avoid this, he is prepared to "resign his military position and return to the farm." If FU is unable to work out an arrangement suitable to both himself and the Communists, he can still escape Peiping, attempt to rejoin his "personal troops," believed to have "escaped" in the evacuation of Kalgan, and once again set up a semi-autonomous regime in Suiyuan.

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The Nanking conference of leading generals and governors which CHIANG Kai-shek called in an effort to gain a vote of confidence for continued resistance to the Communists is unlikely to attain the desired results. FU Tso-yi, who is reliably reported to be negotiating with the Communists in North China, declined to come, as did also MA Hung-kwei, independent Moslem warlord of the Northwest. PAI Chung-hsi, Central China commander who figured prominently in the current attempt to bring about CHIANG's resignation and an armistice with the Communists, likewise failed to appear. None of the generals in threatened areas apparently favors continued resistance, although YEN Hsi-shan, Governor of Shanai, might drive a bargain with the National Government for supplies. Both YEN and Governor T. V. SOONG of Kwangtung have made personal inquiries regarding prospects for future US aid and support.

"A"

CHIANG Kai-shek's New Year speech indicates he apparently does not yet intend to relinquish power despite his offer of peace to the Communists and the expectancy on the part of many leading figures that he would retire in favor of Vice President LI Tsung-jen. CHIANG took the initiative in making a bid for peace but attached such conditions as to preclude its being accepted by the Communists, at the same time attempting to put the onus on the Communists for continuing the civil war. CHIANG said that he would be satisfied by the following conditions: if a negotiated peace is not detrimental to national independence and sovereignty, if the Constitution is not violated and constitutionalism is preserved, the democratic form of government maintained, the entity of the armed forces safeguarded and the "people's free mode of living and the minimum living standard" protected. CHIANG continued: "If peace can be secured, I am not at all concerned about my own position. In this, I will follow only the consensus of the people." He then said that if the Communists "are not sincerely desirous of peace" and "insist on continuing the armed rebellion" the Government "with no other alternative, will fight them to the finish." Though the peace movement within the National Government now includes nearly everyone but CHIANG himself, as long as he continues to control the secret police and Nanking garrison, concerted efforts by key officials to persuade him to retire are not likely to materialize since his challengers hesitate to take the initiative in forcing his departure.

"B"

National Government plans for safe haven in Taiwan. The sudden removal of WEI Tao-ming as Governor of Taiwan and the appointment of Gen. CHEN Cheng, former Chief of Staff, as his successor, evidence the National Government's intention of strengthening its control over that area. As a civilian official of moderate capacity, WEI recently has been critical of Nationalist policies and has favored greater autonomy for the Taiwan Provincial Government. General CHEN not only

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is an able military administrator but his loyalty to CHIANG Kai-shek is unquestioned. The Generalissimo's son, CHIANG Ching-kuo, recently economic czar of Shanghai, has been appointed Chairman of the Taiwan Provincial Kuomintang Headquarters, replacing a less prominent party leader. These appointments coincide with reports of the arrival in Taiwan of many Nationalist officials and/or their families who are chiefly adherents of the Right wing of the Kuomintang. Recent shipment to Taiwan of some of the Generalissimo's personal property also suggests official concern with use of the island as a safe haven and a future anti-Communist base of operations for a refugee National Government. The newly-appointed provincial administrators, the transfer to the island of Nationalist naval and air units and the influx of Nationalist leaders will buttress immediately the National Government's position in Taiwan. However, these developments also will increase Taiwanese hatred of Nationalist rule, create resentment among the provincial Chinese officials and residents, contribute in the long run to greater instability, and invite Communist infiltration.

Sinkiang Governor MESUD has been replaced by BURKHAN, a Sinkiang native generally regarded as acceptable to the pro-Soviet Ili Group. In 1947 Ili leaders withdrew from the Provincial Government in protest against the appointment of MESUD; they have since demanded MESUD's removal from the governorship as a condition for their participation in the Provincial Government. The removal of MESUD thus paves the way for a reconciliation between the Ili Group and Chinese authorities in Sinkiang. A reorganized Provincial Government including Ili leaders is likely to result, thereby forestalling the threat of a new anti-Chinese rebellion and leading to an increase of Soviet influence throughout Sinkiang. "A"

CHANG Chih-chung, Commander of Northwest Headquarters, who has long advocated settlement of the Sinkiang problem by negotiation and conciliating the Ili Group, has been urging the National Government to replace MESUD with BURKHAN for over a year. Probable reasons for Nanking's acceptance of CHANG's recommendation at this time are: a) CHANG is currently persona grata with the Chinese Communists, thus making him a person of prestige and value to the National Government; b) Nanking has belatedly realized the impossibility of maintaining Chinese control of Sinkiang by force, and is, therefore, moving toward a policy of conciliating the dissident native elements.

Growing autonomy sentiment in Szechwan presages probable future efforts by the western provinces to establish regional regimes as the Nanking Government approaches complete collapse. In Szechwan the desire for autonomy is being manifested by failure to meet quotas of rice shipments from the province, return of gold and silver released to the National Government under the 19 August measures, issuing "G"

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provincial auxiliary currency and growing independence of provincial defense units. Virtual autonomy within the National Government orbit is apparently the first objective. However, in the event of the complete collapse of Nanking, attempts will probably be made to effect a working agreement with the Communists whose influence in parts of the province is believed already too strong to be suppressed by local elements. Liberal elements in the province will probably consider it to their advantage to join with Szechwanese national officials, including old warlords, during the changeover period.

Communists predict Communist-controlled government of China in 1949. A Chinese Communist broadcast of 31 December rejected in advance whatever peace proposals might be offered in CHIANG Kai-shek's New Year Message, and made clear that the Kuomintang as a party will not be included in the "coalition government" promised for 1949. The broadcast summarizes an editorial of 30 December, "exposing the peace intrigues of the reactionary party," and calling upon "the Chinese people and the Chinese Communist Party" to "work hand in hand to eradicate all reactionary elements and oust American imperialism from China."

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The editorial stated that Communist armies, during 1949, will push south of the Yangtze, and the Communists "will call a political consultative conference from which all reactionary parties will be excluded." Thereafter, the Communists will take the lead in forming a central coalition government, "to be participated in by 'various democratic parties and people's organizations' which are already allied with the Communist Party. Although the editorial does not so state, it remains probable that a large number of Nationalist functionaries, as individuals rather than as Kuomintang representatives, will continue to function in the Communist-controlled 'coalition.'"

Soviet Embassy strengthens its staff, returns dependents to China. For several months the USSR has been removing from China the dependents of Soviet representatives in Nationalist territory. Recent additions to the USSR's offices in Nanking and Shanghai include 20 Soviet officials, 23 wives, and 12 children. The new officials, some of whom have already given distinguished service in China, will undoubtedly strengthen the Soviet representation. The return of non-essential dependents to Nanking and Shanghai may indicate that the USSR no longer anticipates any great violence in the turnover of those cities to the Chinese Communists.

"C"

Explosive inflation again struck Nationalist China last week as uncontrolled note issue stimulated the sharpest price spiral of 1948. The 30-fold rise in prices and value of the US dollar since 1 September, 1948 approximately equals the increase during the first eight months of 1948. Despite reduced Government expenditures caused by the loss of North China, the Northeast and many armies, and the contracting area of Gold Yuan circulation, the note issue has risen to at least

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GY \$8 billion. Reduced tax revenues and anticipation of a Communist victory combine to devalue the Gold Yuan. Consequently tremendous inflationary pressures have formed which the Government cannot ease.

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INDONESIA

Dutch adopting conciliatory tactics in Indonesia. With the close of "A" Dutch police action against the Republic, the Netherlands is preparing to adopt a more conciliatory attitude on the Indonesian problem. This changed, were liberal viewpoint, now that Dutch aims have been accomplished by use of force, is an obvious effort to allay world opinion and to win the cooperation of influential Indonesian nationalist leaders. It may also reflect considerable pressure from left-wing groups in Holland. The Netherlands Premier and the Dutch Ambassador to London are making a special trip to Indonesia to expedite establishment of the joint Dutch-Indonesian interim government. The Dutch have already suggested that US CGC Delegate Cochran intercede for them with Republican leaders, whose cooperation they consider vital for the success of the interim government and for containment of guerrilla activities. In another effort to win Indonesian support the Dutch may consider the removal of High Commissioner Beel, who was also in a position of authority in the Netherlands during the Dutch police action of July 1947.

The Dutch policy will be regarded with suspicion in Indonesia where no Republican leader could muster enough popular support to form an effective government were he to accept Dutch terms. Another strong deterrent to immediate collaboration is the relatively strong international support which the Republic has attracted. This same factor will no doubt cause other Indonesian leaders to hesitate before accepting positions under the Dutch.

INDOCHINA

Possible collapse of the French-sponsored Xuan Government. Despite "A" French High Commissioner Pignon's belief that the question of Vietnamese foreign affairs is the major stumbling block to the return of former emperor Bao Dai to Indochina, it is doubtful that the current conversations in Paris will decisively strengthen the Vietnam Central Provisional Government of President Xuan. The inactivity and disunity of the Vietnam delegation at the recent Dalat economic conference; the necessity for Xuan's government to deny rumors of Cao daist (a strong religious movement) abandonment of Xuan; President Xuan's denial of his reported intention to remodel the government before "the return of Bao Dai"; Xuan's insistence that his family accompany him even on a short official trip to Paris; and finally the resignation of three outstanding members of the Provisional Government, all underline the possibility of an imminent breakdown of the Xuan Government. The immediate reason for the resignations of these leaders apparently stems from dissension within the government over the distribution of authority among the ministries and the regional governors. This, however, is probably secondary to the failure of the Xuan Government to effect a more rapid realization of the French plan for Bao Dai's restoration as emperor.

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BURMA

Political and economic situation likely to deteriorate further in 1949. "p" Political and economic conditions in Burma are likely to become progressively worse during 1949. Lawlessness and the insurgency of several disaffected political elements continues unabated in Rangoon and throughout most of the country. Government military efforts to restore law and order are still often half-hearted and ineffective. There are no indications that the delicate Karen minority problem will be settled in the foreseeable future, and it is believed that many Karens will fight if they are not granted a separate state through current negotiations. The already truncated Anti-Fascist Peoples' Freedom League (AFPFL), the Government party, recently lost more support with the disaffiliation of the All-Burma Youth League. The authority of the AFPFL Government extends only over limited areas of the country. Furthermore no effective leadership has developed from any political group.

Economic prospects for the coming year are no brighter than the political. Burma's financial position, both internally and externally, is expected to continue to deteriorate. Rice exports for 1948 fell some 270,000 tons short of the original target, largely because of insurgent activities, and will probably miss the 1949 target by an even greater margin. All major saw mills may have to close down in the near future because of insurgent interference with the extraction and transportation of teak logs. Furthermore, the Government's nationalistic policies may force the Burmah Oil Company and various British mining enterprises to suspend operations. Since rice, teak and minerals are Burma's major exports, the economic loss through such developments is obvious. An additional problem will be created by considerable unemployment which in turn is likely to create additional unrest. The breakdown of transportation will increasingly interfere with domestic commerce and prevent badly needed consumer goods from reaching many areas of Burma in sufficient quantities.

As the French Minister to Burma recently stated, "While things in Europe have been serious they have seldom been desperate, but in Burma things are always desperate, but seldom serious."

PHILIPPINES

Philippines begins import control and managed monetary system. The Philippines has begun 1949 by implementing two, long-planned economic measures. On 28 December, President Quirino issued an executive order carrying out legislation passed in June 1948 for the control of imports of luxuries and non-essentials. On 3 January, the Central Bank opened for business. Both of these measures were recommended with some degree of urgency by the Joint Philippine-American Finance Commission in June 1947 as logical steps in making the Philippine economy less dependent upon the US. "B"

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~~CONFIDENTIAL~~PHILIPPINES (continued)

The purpose of import control is to conserve the current extraordinary dollar income for constructive use. The executive order establishing it set up quotas on some 122 articles at rates 20 to 95 per cent below the imports of these articles in fiscal year 1948. Both those products considered unnecessary to the Philippine economy and those for which domestic substitutes are or can be made available were included. Eighty per cent of the import quotas will be allocated to established importers and the remainder set aside for new applicants. On a statistical basis the measure would reduce imports by approximately \$45 million.

The Central Bank will, when its organization and procedures are completed, convert the Philippine monetary system from its present dollar exchange standard to a managed system. The Joint Finance Commission in recommending this departure felt the step was necessary in order to facilitate domestic financing and better control over the country's economic development. Miguel Cuaderno, who headed the Philippine Section of the Finance Commission, resigned as Secretary of Finance to become Governor of the Central Bank. Cuaderno is largely responsible for the Central Bank legislation and is well qualified for the position. He will, at the outset, be assisted by a central banking expert from the US Federal Reserve Bank.

Both import control and central banking legislation have received opposition from US business interests in the Philippines. In negotiating with the World Bank for loans to finance hydroelectric projects, however, Philippine representatives were under pressure to carry out these measures which had been recommended by the Joint Finance Commission. There is little question that they are logical steps in the evolution of an independent economy if soundly administered. Their implementation marks a recognition on the part of the Philippine Government that preparation for an anticipated decrease in extraordinary income from the US can not too long be delayed.

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